Nos. 486 and 488

FEB 1 19
MICHAEL RODAK, JR.

IN THE

Supreme Court of the United States

October Term, 1972

Supreme Court, U.S.
FILED
FEB 26 1973
MICHAEL RODAK, JR., CLERK

No. 486

FEDERAL POWER COMMISSION,

Petitioner,

v.

MEMPHIS LIGHT, GAS AND WATER DIVISION, *et al.*

No. 488

TEXAS GAS TRANSMISSION CORPORATION,

Petitioner,

v.

MEMPHIS LIGHT, GAS AND WATER DIVISION, *et al.*

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND BRIEF FOR *AMICI CURIAE*,

Jersey Central Power & Light Company
Metropolitan Edison Company
New Jersey Power & Light Company
Pennsylvania Electric Company

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February 1, 1973

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ION FOR LEAVE TO FILE BRIEF *AMICI CURIAE*

rsey Central Power & Light Company, Metropolitan
n Company, New Jersey Power & Light Company,
ylvania Electric Company ("Movants") hereby re-
fully move for leave to file the annexed brief amici
e in this proceeding.*

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*vants file this Motion since their request for consent for the
of the annexed brief was granted by Petitioners, Federal
Commission and Texas Gas Transmission Corporation, but
by Memphis Light, Gas and Water Division and Public
Commission of the State of New York.

Movants are four electric utilities which, pursuant to the provisions of the Federal Power Act, are subject to the jurisdiction of the Federal Power Commission (FPC). Movants provide electric energy to both retail and wholesale customers in portions of the states of New Jersey and Pennsylvania. All of the common stock of each of the Movants is owned by General Public Utilities Corporation, a holding company subject to the jurisdiction of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935.

The interest of the Movants in these proceedings stems from the jurisdiction which the FPC at the wholesale level and state commissions at the retail level have over their electric rates. Although the decision of the Court below deals only with the impact of the Tax Reform Act of 1969 on rate-making by the FPC under the Natural Gas Act, the interpretation by the Court below of subsection 167(l) of the Internal Revenue Code would also apparently deny (except in extraordinary circumstances) to all rate regulatory agencies discretion to permit a change in income tax depreciation of pre-1970 property for ratemaking purposes from liberalized depreciation with flow-through to straight-line depreciation or liberalized depreciation with normalization. The Movants believe that the interpretation of the Court below was incorrect and if not reversed will have a significantly adverse impact upon their earning and financing.

No electric utility company is a party to these proceedings and Movants do not believe that any of the parties to these proceedings can properly be expected to demonstrate to this Court the effect which the decision of the Court below, if not reversed, will have upon electric utilities.

Accordingly, Movants respectfully ask this Court for permission to file the annexed brief.

February 1, 1973

Respectfully submitted,

THOMAS M. DEBEVOISE
Attorney for
Jersey Central Power & Light Company
Metropolitan Edison Company
New Jersey Power & Light Company
Pennsylvania Electric Company

In the

Supreme Court of the United States

October Term, 1972

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Federal Power Commission,

Petitioner,

v.

Memphis Light, Gas and Water Division, *et al.*

No. 488

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Memphis Light, Gas and Water Division, *et al.*

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR *AMICI CURIAE*,

Jersey Central Power & Light Company
Metropolitan Edison Company
New Jersey Power & Light Company
Pennsylvania Electric Company

Question Presented

Whether Congress intended by subsection (l) of Section 167 of the Internal Revenue Code (added by Section 441

of the Tax Reform Act of 1969) to withdraw from the Federal Power Commission (and other federal and state rate regulatory agencies) the authority and discretion to permit a utility to change, for rate-making purposes, its method of tax depreciation of property acquired prior to 1970 from liberalized depreciation with flow-through to either straight-line depreciation or liberalized depreciation with normalization.

The Interest of the *Amici Curiae*

The *amici curiae* are electric utility companies whose rates for retail electric service are regulated by state commissions under the state laws establishing such commissions and whose rates for wholesale for resale electric service are regulated by the Federal Power Commission (FPC) under the Federal Power Act, 16 U.S.C. 791a *et seq.* Prior to the enactment of the Tax Reform Act of 1969, such rate regulatory agencies had exercised their discretion to require that the allowable electric service rates of the *amici curiae* be determined on the basis of liberalized tax depreciation with flow-through. As a result of the enactment of the Tax Reform Act of 1969, the *amici curiae* are seeking to have their electric service rates determined on the basis of liberalized tax depreciation with normalization for *all* their depreciable property.

In form the decision of the Court below deals only with the impact of the Tax Reform Act of 1969 on rate-making by the FPC under the Natural Gas Act, 15 U.S.C. 717-717w. However, the interpretation by the Court below of subsection 167(l) of the Internal Revenue Code would also apparently deny (except in extraordinary circumstances) to all rate regulatory agencies having jurisdiction over utilities supplying retail or wholesale electric, gas, water or

steam services *discretion* to permit a change in income tax depreciation of pre-1970 property for rate-making purposes from liberalized depreciation with flow-through to either straight-line depreciation or liberalized depreciation with normalization. The *amici curiae* believe that the Court below did not correctly interpret subsection 167(l). They, therefore, urge that the decision of the Court below be reversed.

Statement

In order to avoid duplication, the *amici curiae* hereby adopt the Statement in the brief for Petitioner, Texas Gas Transmission Corporation (Texas Gas).

ARGUMENT

I.

The provisions of subsection 167(l) of the Internal Revenue Code do not, by their terms, restrict the exercise of Commission *discretion* to permit a utility to change *from* liberalized tax depreciation with flow-through with respect to pre-1970 property.

This case principally involves two of the five subdivisions of Subsection 167(l), namely,

I. Subdivision (l)(1) dealing with public utility property acquired before 1970 ("pre-1970 property"); and

II. Subdivision (l)(4) providing certain specific rules with effect to the flow-through method.

Subdivision (l)(2) deals with public utility property acquired after 1969 ("post-1969 property"); while this Subdivision is also involved in the Commission's order here under re-

view, since the bulk of the property involved is pre-1970 property and the same rule applies to the post-1969 non-expansion property, we have cast our analysis and argument in terms of the pre-1970 property for simplicity. Subdivision (l)(3) contains definitions applicable to Subdivisions (l)(1) and (l)(2). Subdivision (l)(5) deals with reorganization and similar matters.

Subdivision (l)(1) provides, in substance, that, for Federal income tax purposes, *in the case of pre-1970 property*, a utility covered by Subdivision (l) (an "affected utility") *may*, subject to certain conditions:

A. Use straight-line depreciation (Method 1); *or*

B. Use liberalized depreciation with normalization (Method 2); *or*

C. Use liberalized depreciation with flow-through (Method 3).

See Section 167(l)(1)(A)(i), (ii) and (B)(i).

All affected utilities may use Method 1.

Utilities on liberalized depreciation in 1968 *may, in the alternative*, use Method 2.

Utilities on liberalized depreciation with flow-through in July 1969 *may, in the alternative*, use Method 3.

As a result, *with respect to pre-1970 property*, (i) affected utilities which used straight-line depreciation in 1968 have to remain on that method and cannot switch to another method; and (ii) affected utilities which used liberalized depreciation with normalization in July 1969 cannot switch to liberalized depreciation with flow-through.

The restrictions in subdivision (l)(1) on changes in the method of tax depreciation of pre-1970 property are restrictions on change in one direction, but not in the other.

By denying to affected utilities with respect to such property (a) the right to use liberalized tax depreciation if they were not using it in 1968 and (b) the right to use liberalized tax depreciation with flow-through if they were not using it in July 1969, Congress protected the federal government against an increase in the loss of tax revenues which had already reached the level of $1.5 to $2.0 billion annually. Moreover, recognizing that income taxes are part of the allowable costs of service for rate regulatory purposes as established by this court in *Galveston Electric Company* v. *City of Galveston*, 258 U.S. 388, 399 (1922), Congress also relieved affected utilities from pressure by rate regulatory agencies to change their methods of tax depreciation of pre-1970 property from Method 1 (straight line) to Method 2 (liberalized depreciation with normalization) or Method 3 (liberalized depreciation with flow-through), or from Method 2 to Method 3.

On the other hand, there is nothing in the express terms of subdivision (1)(1) which provides, or even suggests, that a utility is restricted in changing *from* liberalized depreciation with flow-through to either liberalized depreciation with normalization or to straight-line depreciation, or from liberalized depreciation with normalization to straight-line depreciation. To the contrary, in view of this omission, it is apparent that Congress did not intend to modify past practices with regard to such changes, including the opportunity for review and approval or disapproval of such changes by the appropriate regulatory agency.[1]

[1] If a utility does change from Method 3 to Method 1 or 2 with respect to pre-1970 property and its rate regulatory agency refuses in its discretion to recognize that change, the economic consequences to the utility and its consumers and investors will be severe. For this reason, a utility is unlikely to make such a change unless it believes that its rate regulatory agency will recognize the change.

Paragraph (A) of Subdivision (l)(4) grants to a utility the *right* to elect, within 180 days after the enactment of the Tax Reform Act of 1969, to shift from liberalized tax depreciation with flow-through for post-1969 property representing growth in capacity (usually referred to as "expansion property"). The consequence of this election is to *require* its rate regulatory agency to change its rate-making policies with *respect to expansion property;* i.e., an electric utility may *require* the rate-making agency to fix rates on straight-line tax depreciation for expansion property unless the agency permits it to use liberalized tax depreciation with normalization with respect to that property.

Since paragraph (l)(4)(A) is limited to post-1969 expansion property, it does not accord a utility the right to make an election which is binding on its rate regulatory agencies with respect to either pre-1970 property or non-expansion post-1969 property. But the fact that the utility cannot *force* a change on its rate regulatory agency is no warrant for denying to the rate regulatory agency the power, *in its own discretion,* to permit the utility to make the change, if the agency finds the change justified.

The Senate Finance Committee version of the bill that became the Tax Reform Act of 1969 had granted affected utilities an election *forcing* their rate regulatory bodies to fix rates on the basis of either straight-line tax depreciation or liberalized tax depreciation with normalization for *all property.* The Conference Committee version of the Bill that was enacted (i.e., paragraph (l)(4)(A)) limited the utility's election to post-1969 expansion property. The Court below reads this change as a demonstration of Congressional intent to preclude a rate regulatory agency as a matter of *discretion* from changing from liberalized depreciation with flow-through for pre-1970 property. If Congress had intended this result, surely it would have

made it explicit. Nothing in the legislative history indicates that this denial of discretion may be fairly implied from the words of the statute. Explicit language denying a rate regulatory agency the right to permit a utility to change to liberalized depreciation with normalization with respect to its pre-1970 property would logically have appeared in paragraph (1)(4)(B). But that paragraph merely provides that, for purposes of paragraph (1)(1)(B), a utility that had pending on August 1, 1969 a timely application to change to flow-through with respect to pre-1970 property will be treated under certain conditions as if it were using flow-through in July 1969.

Stated in another way, subsection (1) *expressly* prohibits a utility from changing *to* liberalized depreciation with flow-through for *any property* if the utility was not employing flow-through in July 1969. Subsection (1) also *expressly* prohibits a utility from using liberalized depreciation with flow-through for *expansion property* if the utility made the election to that effect permitted by paragraph (1)(4)(A). But nothing in subsection (1) expressly prohibits a utility from changing *to* straight-line tax depreciation or to liberalized tax depreciation with normalization, even though it would have been entitled to use liberalized tax depreciation with flow-through if it wished. Similarly, nothing in subsection (1) expressly requires a rate regulatory agency to refuse recognition to such a change by the utility if the regulatory agency finds such a change consistent with the regulatory statutes which it is administering.

The conclusion of the Court below that Congress intended this result has no support in the express terms of the actual legislation that was adopted and is based solely on an unfounded implication that the Court below drew from the changes in the Bill during the course of legislative con-

sideration. As discussed in Point III of this brief, this legislative history supports the conclusion that a regulatory agency's *discretion* to permit a change *from* flow-through was not affected by the Tax Reform Act of 1969.

II.

The consequences of the holding of the Court below are so far-reaching that this holding should be reversed by this Court unless clearly compelled by subsection 167(l).

The Court below correctly held that Congress could limit the discretion of rate regulatory agencies by legislative means other than amendments of the rate regulatory statutes. Congress had previously done so, in the case of federal rate regulatory agencies and the 3% investment tax credit, by the Revenue Act of 1964,[2] and it subsequently did so, in the case of state and federal rate regulatory agencies, by the Economic Stabilization Act of 1970,[3] but, at a minimum, it may be reasonably expected that Congress would be explicit when it intends to exercise such powers.

In the case of subsection (l), Congress clearly recognized that it was limiting the discretion of rate regulatory agencies (state and federal) by precluding them from thereafter fixing rates on a liberalized depreciation with flow-through basis for pre-1970 property if the utility was not using flow-through on July 1969 with respect to that property, and for expansion property, even though the utility had been using flow-through, if the utility made the timely election provided for in paragraph (l)(4)(A).[4] Indeed, the whole of subsection (l) is based upon the rate-making con-

[2] Revenue Act of 1964, Section 203(e); P.L. 88-272, 78 Stat. 19 (1964).

[3] 12 U.S.C. 1904 et seq. 84 Stat. 796, 85 Stat. 743.

[4] S. Rep. No. 552, 91st Cong., 1st Sess. 173-174 (1969).

sequences of limiting the availability of liberalized tax depreciation deductions. But, if the Court below is correct, then Congress was also restricting the discretion of rate regulatory agencies (state and federal) by precluding them from thereafter fixing rates on any basis other than liberalized depreciation with flow-through for non-expansion property for any utility that was using flow-through in July 1969. A careful study of the opinion of the Court below demonstrates, however, that nowhere did the Court below cite any part of subsection (l) or its legislative history to demonstrate that Congress expressly intended this result; nor could it, since the legislative history clearly established the contrary.

Ever since the *Hope* case,[5] if not before, this Court has recognized the necessity of according to rate regulatory agencies broad discretion absent express statutory limitations thereon—a view reaffirmed as recently as the last session of this Court.[6] Yet, in this case, the Court below would reach the contrary result for all rate regulatory agencies, state and federal, based solely upon an implication—an unfounded implication as demonstrated below—from a change in the Bill made during the course of Congressional consideration with respect to the scope of an election made available to utilities.

Both Houses of Congress had recognized, during their consideration of the Bill, that about half of the rate regulatory agencies had required flow-through for any utility that employed liberalized tax depreciation and that some of those rate regulatory agencies had fixed rates on the basis of imputing liberalized tax depreciation with flow-through even if the utility actually employed straight-line

[5] *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

[6] *F.P.C. v. Louisiana Power and Light Co.*, 406 U.S. 621 (1972).

tax depreciation.[7] The rate regulatory agencies requiring flow-through included such important state agencies as the California, New Jersey, New York and Pennsylvania commissions as well as the FPC. To deny to these numerous agencies with broad public responsibilities the opportunity—in their discretion—to modify their position, if changing conditions warrant this or if the premise on which their prior position rested is no longer valid, should require the clearest of express Congressional mandates.

III.

The legislative history of subsection 167(l) does not support the holding of the Court below.

The FPC had followed a tortuous path in connection with liberalized tax depreciation and the Natural Gas Act. In 1956,[8] and again in 1959[9] the FPC permitted liberalized tax depreciation with normalization, but it neither reduced rate base nor accorded separate capitalization treatment to the accumulated normalization credits. This original position of the FPC was affirmed by the Courts of Appeals as being within the FPC's administrative discretion and this Court denied certiorari.[10] In 1961, while it continued to permit liberalized tax depreciation with normalization, the FPC modified its prior position by treating the accumulated normalization credits as a separate component of capitalization entitled to a return of only 1.5% per year,

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[7] H. Rep. No. 413, 91st Cong. 1st Sess. (1969) at 131-132; S. Rep. No. 552, 91st Cong. 1st Sess. (1969), at 171-172.

[8] *Amere Gas Utilities Co.*, 15 FPC 760, 15 PUR 3rd 339 (1956).

[9] *El Paso Natural Gas Co.*, 22 FPC 260, 29 PUR 3rd 469 (1959).

[10] *El Paso Natural Gas Co.* v. *FPC*, 281 F.2d 567 (5th Cir. 1960), (reversing, on other grounds, *El Paso Natural Gas Co.*, 22 FPC 260, 29 PUR 3rd 469), *cert. denied sub nom.; California* v. *FPC*, 366 U.S. 912 (1961); *City of Lexington* v. *FPC*, 295 F.2d 109 (4th Cir. 1961).

and the FPC's action in changing its prior position was also sustained by the courts.[11] A further change in its position occurred in 1964, when the FPC required a natural gas company using liberalized tax depreciation to also use flow-through[12] and then, in 1966, the FPC decided to impute liberalized tax depreciation with flow-through to a company which was then using straight-line tax depreciation but which had been using liberalized tax depreciation with normalization until the decision in the *Alabama-Tennessee* case.[13] In each case, the court's affirmance of the FPC position was based upon the broad administrative discretion accorded to rate regulatory agencies. The following comment from the Court of Appeals in its *Alabama-Tennessee* opinion is particularly pertinent:

> "• • • The Commission must, of course, concern itself with the possibility of having misread the future and with the future's taking a turn without benefit of advice from the Commission. All things change. But we should expect the agency policy to be sufficiently flexible to attempt to change with changing times. Sufficient unto the day is the evil thereof."[14]

The only conclusion that Congress could have drawn from this zig-zag series of interpretations by the FPC with Court approval (and the repeated refusals by this Court

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[11] *Northern Natural Gas Co.*, 25 FPC 431, 38 PUR 3rd 149 (1961); *Panhandle Eastern Pipe Line Company* v. *FPC*, 316 F.2d 659 (D.C. Cir. 1963).

[12] *Alabama-Tennessee Nat. Gas Co.*, 31 FPC 208, 52 PUR 3rd 118, affirmed *Alabama Tennessee Nat. Gas Co.* v. *FPC*, 359 F.2d 318 (5th Cir. 1966), *cert. denied* 385 U.S. 847 (1966).

[13] *Midwestern Gas Transmission Co.*, 36 FPC 61, 64 PUR 3rd 433 (1966), affirmed *Midwestern Gas Transmission Co.* v. *FPC*, 388 F.2d 444 (7th Cir. 1968), *cert. denied*, 392 U.S. 928 (1968).

[14] *Alabama-Tennessee Natural Gas Co.* v. *FPC*, 359 F.2d 318, (5th Cir. 1966).

to intervene) was that neither the Natural Gas Act nor the Internal Revenue Code mandated any particular rate-making treatment of liberalized depreciation and that the FPC had broad discretion with respect thereto.

One of the early suggestions with respect to this subject made to Congress while the Tax Reform Act of 1969 was being developed was the suggestion of FPC that Congress completely withdraw from utilities the right to use liberalized depreciation.[15] Neither the House Committee nor the Senate Committee adopted the FPC's recommendation which would have adversely affected all utilities that were not at the time using straight-line tax depreciation, until they obtained offsetting rate increases. Instead, the House Committee "determined in general to 'freeze' the current situation" [16] insofar as the existing property of affected utilities is concerned. What was the "freeze" upon which the House Committee thus determined with respect to existing property? It was (i) to deny liberalized tax depreciation in the future to those utilities that were not using it in 1968 and (ii) to deny liberalized tax depreciation to utilities that were using it in July 1969 with normalization unless they continued to use normalization. It was a "freeze" *against movement toward* flow-through. It expressly did not "freeze" the utilities that had been using flow-through into continued use of flow-through; on the contrary, the House Committee expressly recognized that the appropriate regulatory agency could permit a change *from* flow-through[17] and the Court below held that, if the House version had been enacted, the FPC and Texas Gas position would have been clearly justified.

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[15] H. Rep. No. 413, 91st Cong. 1st Sess. (1969) at 132.

[16] *Id.*, at 132-133.

[17] *Id.*, at 133.

The Senate Committee version essentially followed the House version except in one respect. Under the House version, a utility that had been using liberalised depreciation with flow-through could not *force* its regulatory agency to recognise a change away from flow-through, but the agency had discretion to permit such a change. Under the Senate version, such a flow-through utility was given an additional, absolute right, with or without regulatory agency permission, to shift to straight-line depreciation or—with regulatory agency permission—to shift to liberalised depreciation with normalization with respect to both new and existing property.[18] The Senate Committee characterised its action as follows:

> "Accordingly, the Committee agrees with the House that it is appropriate to in general 'freeze' the current situation regarding methods of depreciation * * *."

Once again the only "freeze" was *against* a change *to* flow-through; under the Senate version, the utility could *require* its regulatory agency to accept a change *from* flow-through, but, under both the House and Senate versions, a regulatory agency could *permit* a change *from* flow-through with respect to property as to which the election was not available or exercised within 180 days of the enactment of the Tax Reform Act of 1969. It was in this light that the Senate Committee Report stated:

> "Both the House bill, and the [Senate] committee amendments provide that in the case of existing property the following rules are to apply:
>
> * * *
>
> "(3) If the taxpayer is taking accelerated depreciation and flowing though to its customers the benefits of

[18] S. Rep. No. 552, 91st Cong. 1st Sess. (1969) at 173.

[19] *Id.*, at 172.

the deferred taxes, then the taxpayer would continue to do so (except as provided under the committee amendments which are discussed below), unless the appropriate regulatory agency permits a change as to that property." [20]

The Senate Committee amendments, which were adopted by the Senate, made no change in this *general* rule established by both the House and the Senate versions. Those amendments did not, in this respect, even deal with what became subsection 167(l)(1). Instead, such amendments added a *special* rule—one to be invoked by an election made within 180 days by a utility that had been on flow-through but wished to change from flow-through and to impose that change on its regulatory agency.

It was this *special* rule first adopted by the Senate, and not the general rules that had been agreed to by both the House and the Senate, that was the subject of the Conference Committee compromise. The Conference Committee also did not modify, in this respect, what became subsection 167(l)(1); instead, it modified the provision that became subsection 167(l)(4) so as to limit to expansion property the election that a utility could make as of *right* without obtaining its regulatory agency's consent.[21] It is in this context that the Conference Committee Report stated:

"The conference substitute * * * follows the Senate amendment except that * * * the 180-day election (item (d), above) is modified to apply to new property and not to replacement property. Even in the case of new property, however, the right[22] to change over from the

[20] *Id.*, at 172-73.

[21] Conf. Rep. No. 782, 91st Cong. 1st Sess. (1969) at 312-313.

[22] Obviously the *right* referred to the Conference Committee is the right of the utility, exercisable by its election and binding upon its regulatory agency whether or not the latter consented.

flow-through method is to be available only to the extent the new property increases the productive or operational capacity of the company." [33]

It is clear that the error made by the Court below in its analysis of the legislative history stems essentially from its failure to distinguish between (a) "any *power the regulatory agency* might have to require the taxpayer to flow-through" [34] with respect to existing property if the taxpayer was previously using flow-through and (b) the *right of the taxpayer* to make an election, binding upon its regulatory agency, to change from flow-through with respect to expansion property.[35] It was only the right of the taxpayer, first granted by the Senate Committee amendment, that was the subject of the Conference Committee modification so that thereafter the *taxpayer* had no *right* to make an election with respect to existing property. But none of this affected the *power* of the *regulatory agency* to require the continued use (by imputing it for rate-making purposes if it were not in fact used) of flow-through for existing property if the taxpayer had previously used it, or to permit a change therefrom pursuant to the third *general* rule of both the House and the Senate committee reports.

In its original opinion, and even more in its opinion on rehearing, the Court below laid stress on the Congressional statements of the intent "to freeze" generally tax depreciation accounting for utilities. But since the "freeze" language appears in both the House and Senate Committee reports, in respect of both of which the Court below ex-

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[33] Conf. Rep. No. 782, 91st Cong. 1st Sess. (1969) at 313.

[34] General Explanation of the Tax Reform Act of 1969, prepared by the Staff of the Joint Committee on Internal Revenue Taxation (3 December 1970) at 151.

[35] *Id.*, at 152.

pressly recognized there was clear provision for a change of a company *from* flow-through with respect to existing property, this "freeze" language cannot sustain the heavy burden that the Court below would place upon it.

IV.

The FPC's action in permitting Texas Gas to shift from flow through to normalization with respect to non-expansion property represented an economically sound exercise of administrative discretion.

Most utilities employ straight-line depreciation for general financial accounting and rate-making purposes (usually referred to as "book depreciation"). Book depreciation thus usually involves the amortization of the net cost of property in approximately equal installments over its estimated service life. If a utility uses liberalized tax depreciation without normalization, it is consuming the income tax deductions represented by the amortization of the cost of its property more rapidly than is reflected in its book depreciation charges, so that the book depreciation reserve does not reflect the fact that an important aspect of the value of property (namely, its income tax-reduction quality) has been thus consumed. It is the function of normalization to recognize and make provision for that fact by recording a "normalizing" charge representing the consumption of the income tax deductions that would be associated with future periods if liberalized depreciation were not employed. Ever since 1958, the accounting profession has required normalization in respect of the use of liberalized depreciation by non-regulated companies.[26] In the case of regulated com-

[26] Research Bulletin No. 44 (Revised), Committee on Accounting Procedure, American Institute of Certified Public Accountants (1958).

panies, the accounting profession recognized that the rate regulatory agency's control of the rate-making process also included control of the time when costs would be recognized and revenues allowed in respect thereof, and that the profession could not, therefore, require normalization for regulated utilities if the rate regulatory agency required flow-through.[37]

Initially, as noted earlier, the FPC permitted normalization by natural gas companies. But, in 1964 in *Alabama-Tennessee Nat. Gas. Co.*,[38] it required flow-through. The basis for this requirement was the FPC's conclusion that, for natural gas companies with stable or growing utility plant, under liberalized depreciation the larger tax depreciation deductions associated with new additions to plant would more than offset the reductions in depreciation deductions on older items of plant.[39] This premise of the FPC's conclusion in *Alabama-Tennessee* was that there would be a continuing infusion of larger depreciation deductions resulting from use of liberalized depreciation in respect of new plant additions, so that the utility and rate regulatory agency need not be concerned by the continuing smaller or non-existent deductions in respect of old plant. This premise is completely undercut, however, if a natural gas company exercises its right to switch *from* flow-through in respect of expansion property, as Congress expressly

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[37] *Id.*, at paragraph 8. See also Addendum to Opinion No. 2 of the Accounting Principles Board, American Institute of Certified Public Accountants (1962).

[38] 31 FPC 208, 52 PUR 3d 118 (1964), affirmed 359 F.2d 318 (5th Cir. 1966), *cert. denied*, 385 U.S. 847 (1966).

[39] In retrospect, it is unfortunate that the accounting profession and the FPC have discussed this matter in terms of liability for the payment of taxes rather than in terms of the consumption of that aspect of the value of plant represented by its income tax-reductive quality via depreciation deductions.

permitted by section 167(l)(4)(A). Texas Gas took precisely this action.

Under the circumstances, the FPC could no longer logically insist that Texas Gas employ flow-through for its pre-1970 property. There would clearly be a quickly developing trend of reduced tax depreciation deductions (and, therefore, higher income taxes) and present consumers would be benefitting by the use of tax depreciation deductions properly associated with service to future consumers. By contrast, by allowing normalization, the FPC would be permitting Texas Gas to recognize currently the consumption of income tax deductibility so that each successive generation of its customers would have the benefit of the tax depreciation deductions associated with service to it—but no more.

The increase in rates to present customers resulting from the current normalizing change has the dual effect of (i) providing more cash currently and thereby reducing the amount of new capital to be raised currently and (ii) reducing rate base and, therefore, future charges to customers. In addition, so long as the reserve created by the normalizing charge is deducted from rate base—and this was required by the FPC in this case and as long ago as 1961,[20] normalization of the reduction in income taxes currently payable by reason of liberalized tax depreciation does not increase the earnings available for stockholders.

In other respects, such as the establishment of area rates for natural gas producers and rate differentials in order to stimulate the commitment of additional supplies of natural gas to interstate service, the courts have been willing to recognize the necessity for according wide dis-

[20] *Northern Natural Gas Co.*, 25 FPC 431, 38 PUR 3rd 149 (1961); *Panhandle Eastern Pipe Line Company*, 25 FPC 550, 38 PUR 3rd 307 (1961).

cretion to the FPC. In this instance, with the implications not only for the FPC but also for other rate regulatory agencies, this Court should affirm the action of the FPC as a sound exercise of its administrative discretion.

CONCLUSION

The decision of the Court of Appeals with respect to liberalized tax depreciation in respect of *pre*-1970 and *post* 1969 non-expansion property should be reversed and the decision of the FPC should be affirmed without further proceedings.

Respectfully submitted,

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February 1, 1973